LEGENDS
BANK

October 22, 2012

Basel III Proposed Regulatory Capital Rules
Comment Letter
Missouri Bankers Association

OCC
"Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action"

Via E-mail: regs.comments@occ.treas.gov
Subject Line: OCC
Docket ID OCC-2012-0008
RIN 1557-AD46

OCC
"Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets: Market Discipline and Disclosure Requirements"

Via E-mail: regs.comments@occ.treas.gov
Subject Line: OCC
Docket ID OCC-2012-0009
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Federal Reserve Board
"Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action"

Via E-mail: regs.comments@federalreserve.gov
Subject Line: Docket No. R-1430
RIN No. 7100-AD87

Federal Reserve Board
"Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets: Market Discipline and Disclosure Requirements"

Via E-mail: regs.comments@federalreserve.gov
Subject Line: Docket No. R-1442
RIN No. 7100 AD 87

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FDIC
"Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provision, and Prompt Corrective Action"

Via E-mail: comments@FDIC.gov
Subject Line: FDIC
RIN 3064-AD95

FDIC
"Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets: Market Discipline and Disclosure Requirements"

Via E-mail: comments@FDIC.gov
Subject Line: FDIC
RIN No. 3064-AD96

Re: Proposed Regulatory Capital Rules

Ladies and Gentlemen:

I appreciate the opportunity to comment on the Basel III proposals that were recently approved by each of your agencies.

Legends Bank traces its roots back to 1913, when my grandfather and his brother-in-law lead a group of local individuals in founding what was originally known as the Rich Fountain Bank. Over the next 99 years, the bank at times prospered, and at times struggled, as it survived two world wars, the Great Depression, numerous recessions and the devastating combination of the farm crisis and hyperinflation in the early 1980s. Through the years, Legends Bank has evolved into a $262 million community bank with 10 locations serving five counties in central and east central Missouri. Our branches are located in rural towns varying in population from about 400 to 19,500.

My grandfather and father both preceded me as CEO of Legends Bank. Both preached the importance of maintaining rock solid capital levels to help the bank through tough times. It is a principle with which I agree. However, I strongly disagree with the proposed imposition of the Basel III standards, especially upon community banks. In my opinion the standards are so fundamentally flawed with respect to community banks that the proposal should be scrapped altogether and work begun anew on a much simpler proposal.

Let me begin my critique with that part of the Basel III proposal that would require a portion of a bank's investment portfolio to be marked to market. Such a proposal is flawed in a number of respects. First of all, it would introduce a tremendous amount of volatility to a bank's capital account based solely upon a fluctuation in interest rates – even though the bank's core business and business prospects may not have changed at all. This appears to me to be intuitively wrong. It seems to me that the goal should be to define capital in such a way that it is a stable component of a bank's balance sheet, fluctuating only upon the bank's realized gains and losses, which are determined by many factors in addition to changes in interest rates. I believe many accountants would agree that any attempt to mark to market selected portions of a balance sheet can often result in a skewed picture of an organization because such a practice does not take into account how the organization has positioned itself to either offset or enhance the effects of various risks, including interest rate risks. I believe the preferred practice is to leave the investment portfolio at historical cost, and allow a bank's regulators to gauge whether a bank's capital level is adequate based upon the totality of its risk factors, instead of applying a mandatory write up or write down of its capital based solely upon an actual or projected change in interest rates.

I would respectfully suggest that this proposed mark to market rule would fail a "back testing" to the economic realities of the early 1980's. If the rule had been in effect when short term interest rates soared into the 20% range, I believe that the practical effect would have been the closure of many banks that did in fact survive that crisis and are in fact alive and well today. I'm sure that is not what is intended by the Basel III proposal. However, if I am correct in my back testing assumption, then this fact alone should be sufficient evidence to kill this aspect of Basel III, especially in light of the fact that some economists believe that this country's massive budget deficits coupled with our current policy of monetizing our federal debt could lead us back into a period of hyperinflation.

I would also like to address the treatment of Trust Preferred Securities ("TPS") in the Basel III proposal. While Legends Bank did not take advantage of TPS and so this provision does not affect us, I think that it is fundamentally wrong for the regulatory agencies to now condemn an equity instrument that they approved only a few short years ago. Many banks relied upon the regulators blessing of these instruments and built their capital models around them. Fundamental principles of fairness, not to mention this country's historical adherence to the "rule of law", strongly suggest that such banks be allowed to continue to rely upon issued TPS until their contractual maturity. Adding credibility to such a position is that the Dodd-Frank Act specifically allowed banks under $15 billion in size to continue to utilize TPS as part of their capital. I believe there is a strong legal argument against the regulatory agencies being able to disallow something by regulation that Congress has explicitly permitted by statue.

Turning to the incredible complexity of Basel III, I would submit that its proposed application to community banks is akin to hiring a brain surgeon to assist a patient in applying a band-aid. Most community banks by and large are similar to Legends Bank, with simple business plans and balance sheets. A simple cost-benefit analysis would suggest that the costs associated with tracking all the additional loan characteristics required by Basel III clearly outweigh the benefits. Our regulators have the experience to assess our capital adequately based upon our risk profiles without our bank having to hire additional personnel to track even more minutiae about each of our loans than we already track. I would also respectfully request that you not look at such proposed additional burdens upon community banks in isolation, but instead review them in light of the thousands of pages of additional regulations that community banks are being subjected to as a result of the Dodd-Frank Act.

I believe that there is general agreement that much of the consolidation in the banking industry is being driven by the additional complexity being thrust upon banks by the Dodd-Frank Act. Additional complexity will drive further consolidation. I would submit that such a result is detrimental for our national economy, for our communities and for our industry.

Some of the risk weightings of the Basel III proposal are seriously flawed. For instance, by increasing the weighting for certain delinquent loans, the proposal ignores the present requirement that banks increase their loan loss reserve whenever their loan delinquencies increase. The practical effect is to double the negative effect on capital whenever a loan becomes delinquent. This will make it more difficult for us to work with a customer in distress, as the incentive will be to resolve the delinquency through foreclosure in order to avoid the double penalty associated with the past due loan. This is a terrible result for both the bank and the customer, and directly conflicts with our present practice of resorting to foreclosure only as a last resort.

On a related matter, the risk weighting for residential mortgage loans (RML) under the proposal will at a minimum require us to charge more for RMLs in order to account for the increased capital requirements. At worst we may have to exit at least part of this market, thus eliminating one of the few sources of RMLs in our rural markets. If we exit this market, there will be few, if any, other lenders to take our place. We currently hold over sixty million dollars in RMLs. In order to manage our interest rate risk, virtually of these loans are either balloons or carry a variable rate feature. Many of these loans are not eligible, for one reason or another, to be sold into the secondary market.

Our foreclosure rate on these types of loans is very low, even during the last few years when the housing market has been under great distress. The same is true for home equity loans, which have performed very well for our bank. Thus at least for us the facts do not support the imposition of higher capital requirements for these types of loans. If capital adjustments do need to be made to account for some future increase in the risks associated with these types of loans, it is much simpler, more appropriate and equally effective to make such adjustments through changes to the bank's loan loss reserve.

Finally, I am concerned about the proposed requirement that additional capital be retained for credit enhancing representations and warranties for RMLs sold into the secondary market. This portion of Basel III is incredibly ambiguous, in that it does not define what kinds of representations and warranties are covered, nor the length of time that the additional capital would be required. We are very active in secondary market lending in our market, and all of our conforming, long term fixed rate loans are sold servicing released. Our program is different than most in that the companies which purchase our loans also underwrite them for us. Thus, we are able to negotiate contracts whereby we are not held responsible for any mistakes in underwriting, and so our repurchase obligations are significantly less than banks which do their own underwriting. In fact, we have never been asked to repurchase a loan. In addition, since we sell servicing released, we have no way of tracking which of our sold loans are still outstanding or have been paid off, although we assume that many are no longer outstanding as a result of having been refinanced during the refinance boom of the past several years. Given such, what does the proposal require of Legends Bank with respect to these loans, and for what period of time? If the requirements are too stringent, we will be forced to exit this market since our volume of sold loans could eat capital that we would otherwise need to support the loans we actually keep on our books. Such an exit would be a disservice to our customers and would necessarily require me to lay off a number of our lenders who specialize in these kinds of loans.

It is my understanding that Basel III was originally drafted to apply only to extremely large, complex financial institutions. When about 39 of us from the Missouri Bankers Association visited the regulatory agencies in Washington D.C. in early October, we repeatedly asked who or what agency was responsible for the concept of applying the proposal to community banks. No one would take responsibility. I firmly believe that for the reasons I have set out in this letter, the Basel III proposal in no way fits the community bank model, and should be withdrawn. I believe that if implemented, it would substantially increase the ongoing consolidation of the banking industry, as well as decrease lending by banks when our economic recovery is dependent on the inverse.

Thank you for considering my comments. I would be happy to follow up on any questions you might have.

Sincerely,

John A. Klebba
President

cc: Senator Roy Blunt
Senator Claire McCaskill
Congressman Blaine Luetkemeyer
Mr. Wayne Abernathy, American Bankers Association
Mr. C. Max Cook, Missouri Bankers Association